RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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Sept. 23, 1998 **LETTER 1261**

ALL ABOUT NOTHING: On September 6 the world listened as Treasury Secretary Rubin and Fed Chief Greenspan in long-winded speeches said -- nothing. My reaction was that neither of these two had a clue as to what to do in the current situation. If they did have a clue, they would have let us in on it. They didn't. So no G-7 plan for a structured decline in interest rates, no new, dazzling IMF plan to bail out the world, no plan to counter-act global deflation -- nothing. The next day the stock market realized what our leaders had come up with -- nothing (is this beginning to sound like an episode of Seinfeld?).

Note: Been there, done that? Since the beginning of the world crisis, which began in '97, the IMF has passed out $141 billion to four nations. Thailand and S. Korea are still in poor shape, while Indonesia and Russia remain in states of collapse. These failed bailouts have only served to render the rest of the world increasingly skeptical about what they can expect from the IMF.

THE PICTURE: At the final August 31 lows the stock market was severely oversold, and it appears that the first leg of the bear market had been completed. After all, a decline of 1798 Dow points (19.26%) and a crushing collapse in the advance-lecline ratio serves to discount an awful lot of trouble. What kind of trouble? Currency trouble, devaluation trouble, GDP trouble, pricing trouble, deflation trouble, nations' leaders in trouble, plus trouble out of Washington via a "loose cannon President" who seems incapable of telling the truth.

Volatility has been running extremely high, and as veteran option and commodity traders know, areas of very high volatility, often, **in retrospect**, produce **wide trading-range areas.** Thus, it would not surprise me to see this market "rock-and-roll," whip back and forth for a few weeks or maybe even a few months as the stock market absorbs and discounts every variety of rumor and news -- some good, most bad.

This type of erratic market tends to be one of the most difficult on one's nerves -- and also one of the most difficult to trade. Prepare for a few months of what I term "high confusion" mixed with assorted losses.

Comment: The **disparity** between the action of a limited number of big-cap stocks and the rest of the issues on all exchanges is dramatic. The fact is that the big-cap stocks, while down, have not really fallen apart. On the other hand, the great majority of non-blue-chip stocks have taken a dreadful beating. The following is from *Hussman Econometrics* [(800)487-7626]: "The largest 10% of US stocks account for nearly 80% of the market capitalization. For these overvalued giants, the bear market has hardly begun. The remaining 90% of US stocks represent just 20% of the market capitalization. These smaller stocks have already plunged an average of 40% from their 52-week highs . . . Despite the recent decline, the P/E on the S&P 500 is 24. On record earnings, the historical average has been 12." **Russell Comment**: So on record earnings, the S&P is still selling at **twice** its historical price/earnings ratio. This constitutes a big problem for those who believe that the bull market will soon be revived. What, revived with a P/E of 24?

SUNDRY COMMENTS: The world is in the grip of an historic monetary and credit crisis. Russia has no credit and no currency,

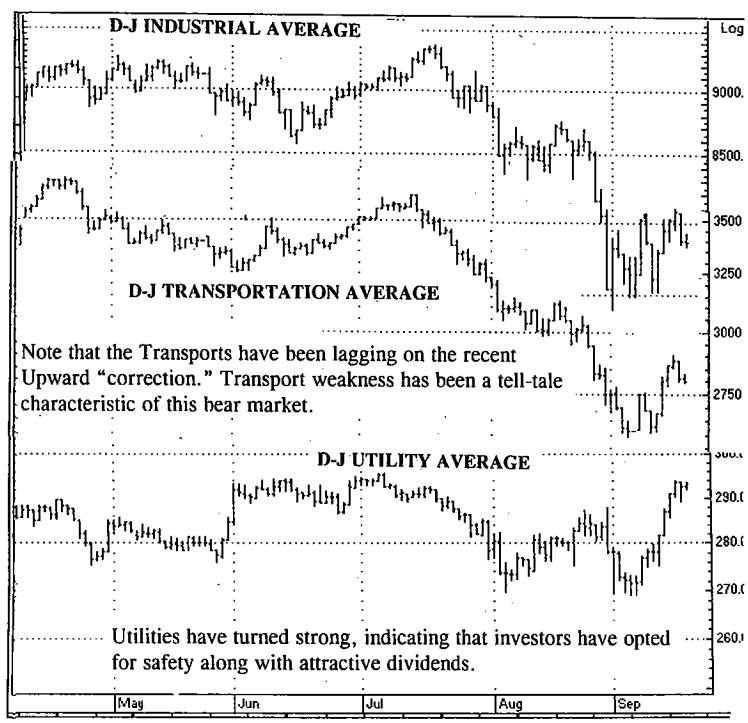
Sept. 11 DJIA 7795.50; PTI 5268; A-D Ratio +3.77
Sept. 18 DJIA 7895.66; PTI 5282; A-D Ratio +4.20
Dow Yield: 1.89%; Dow Price/Earnings: 19.9
Dow 144-day MA: 8520; Dow 34-day MA: 8158
Dow Times Book Value: 4.95; PTI 89-day MA: 5306
Percentage of Undervalued Blue-chips: 6%
Gold 34-day MA: 291

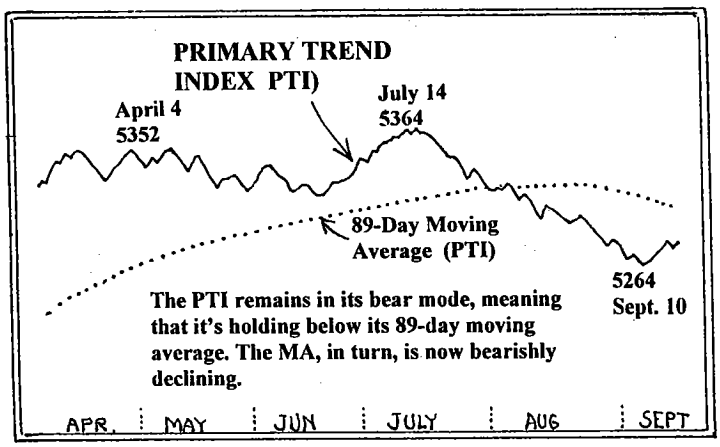
Malaysia has instituted credit controls, Japan is choking on rotten loans, most of Asia has devalued or is in the process of devaluing, and the bear is now moving into South America.

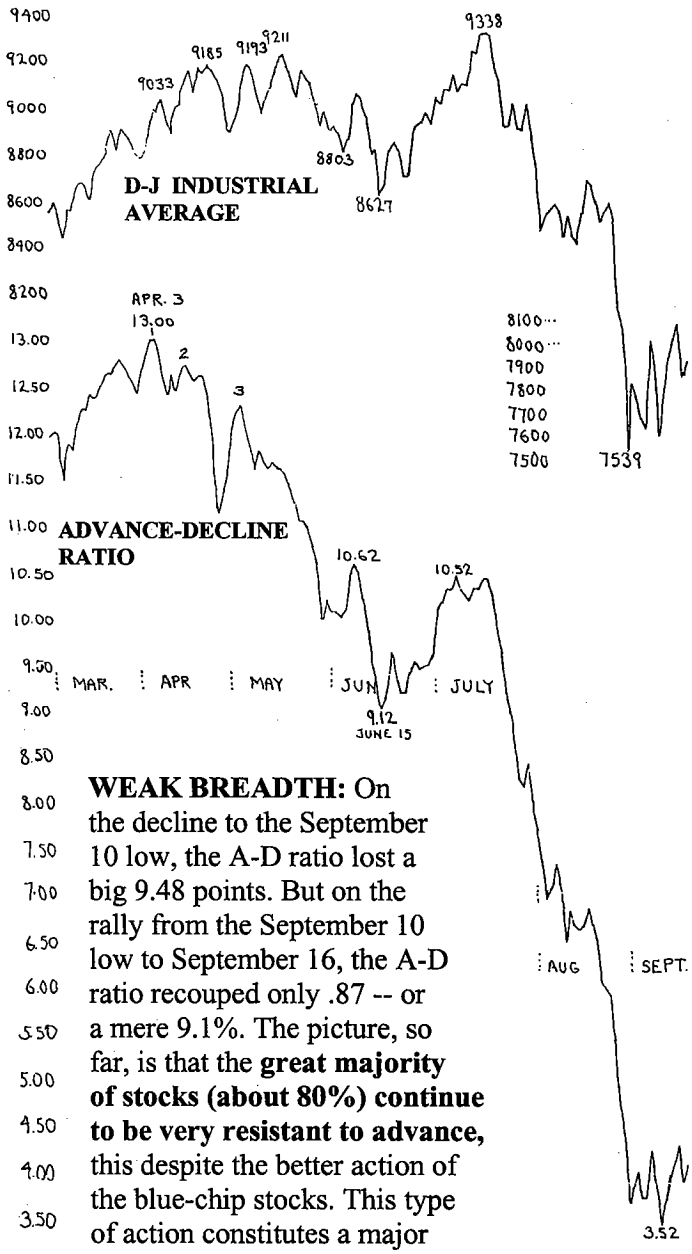
I want to explain that in a primary bear market one pressure point leads to the next pressure point. This is particularly true in our new "One World" economy. The One World concept works wonderfully in a bull market, but in a bear market the One World economy acts like a severe flu epidemic -- eventually everybody catches it.

In the current situation, the Dow and the S&P and even the Nasdaq may not be the most important averages. No, currently the most important average could be the NYSE Financial Average. This is the Average that contains ALL the financial stocks -- banks, S&Ls, brokers, small loans, insurance. I show the Financial Average on page 2. Its already down 28% from its 1998 high, and the bear market is still young.

As subscribers know, I consider Merrill Lynch to be a key financial stock (page 2 chart). Merrill, a giant broker-banker, is very sensitive to forthcoming volume in stocks, bonds, securities, IPOs and deals. During a bear market, volume gradually subsides, so, obviously, MER is extremely sensitive to volume. From a 1998 high of 109, Merrill suffered a loss of over half its value at its September 10 low of 51.







WEAK BREADTH: On the decline to the September 10 low, the A-D ratio lost a big 9.48 points. But on the rally from the September 10 low to September 16, the A-D ratio recouped only .87 -- or a mere 9.1%. The picture, so far, is that the **great majority of stocks (about 80%) continue to be very resistant to advance,** this despite the better action of the blue-chip stocks. This type of action constitutes a major negative in the big picture.

The question I'm most often asked is maybe the toughest one of all. It's "how far down do you think this bear market can carry?" Obviously there is no way of knowing. But there are a few guidelines that might turn out to be useful.

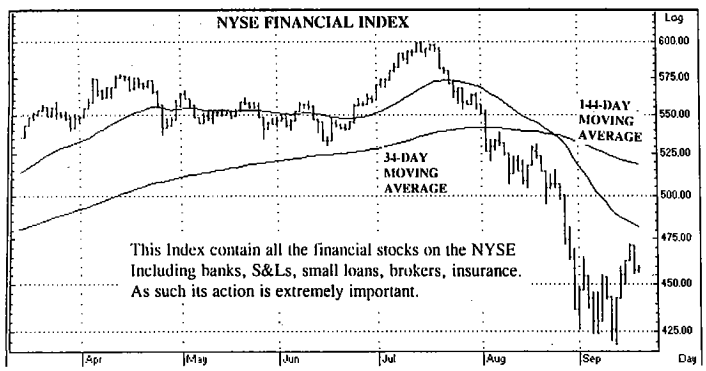
First, in studying all past bear markets I note that most have **wiped out at least half of the gains of the preceding bull market.** That alone causes problems, since there are a lot of arguments concerning when the great bull market actually started.

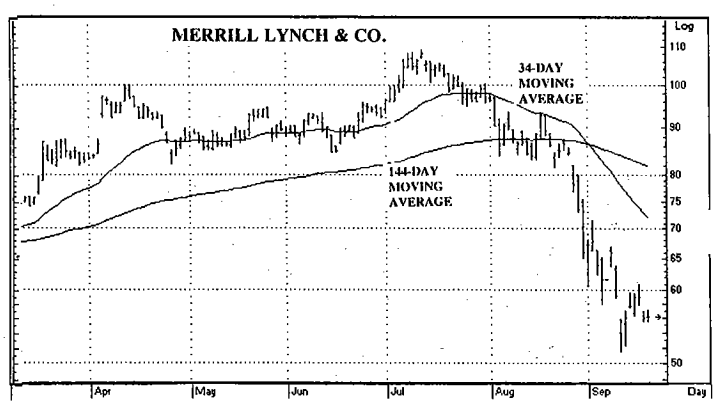
I've always held that the bull market started at Dow 577 in December, 1974 (see last Letter). If you accept the 577 start, and if this bull market was to match the average performance of most previous bull markets -- then it still has quite a ways to go and in a definite southernly direction. Halfway from 577 to the bull market high of 9337 is **4957**. Therefore, if this bear market was to lose at least half of the preceding bull market gains, it could break below 4957, maybe substantially below 4957. And make no mistake about it, that would be extremely painful.

Then there is the time-honored (but now forgotten or discredited) **yield gauge.** If the Dow was to decline to a 3% yield, and remember, a 3% yield used to represent the "dangerous top area for the Dow," it would sell at 5067.

Veteran subscribers may remember that at the 1974 low the Dow declined to the point where it provided a yield of 6% (and, by the way, most major bear markets do finally produce a yield of 6% or more at their low). So if the Dow was to decline to a 6% yield it would sell at 2533 (and that's assuming that there would be no dividend cuts). If the Dow was to decline to a low of 2533 it would have lost 72.8% of its peak value. Can that happen? God help us if that's what we're heading for -- but yes, it can happen.

I might add that we've never experienced a situation like the present one in which all Asia and much of South America is in recession or worse while at the same time business remains good here. Furthermore, we've never seen the leading central banks dedicating themselves to bailing out the world. It should be quite a show, and it could easily produce market action unlike anything that we've ever seen before.





Question: Russell, is there any way of telling whether a bear market is going to be major or minor?

Answer: The only hint is that the more speculative, the bigger, and the frothier the bull market, generally the greater and the more severe the bear market that follows. Remember, bear markets exist for the purpose of **correcting the excesses** of the preceding bull market, and the 1974-'98 bull market was the frothiest in history with nothing else coming even close.

Question: Is there any relation between the first leg of a bear market and the extent and duration of the entire bear market?

Answer: Good question, and I'm just not sure. I do know that in point-and-figure analysis the first break down out of a top formation is often used to estimate the extent of the forthcoming decline. So yes, there probably is some validity regarding the length of the first leg of a bear market and the extent of the forthcoming decline.

If this is true, the picture is anything but pleasant. The bull market ended for the Dow on July 17, 1998 at **9337.97**. I take the first leg as having started at 9337.97 and ending at **7539.07** on August 31. Thus, the first leg lopped off **19.26%** of the price of the Dow. That's a very big first leg. What does it mean? Let me put it this way -- I don't think it's a good omen.

Question: Russell, I note that a lot of technicians are saying that there "should" be one more decline to end this leg of the bear market, and that decline should end somewhere in the October 1 to the end of November period.

Answer: Yes, this is a **very prevalent opinion,** and it may or may not work out that way. However, and this is important, I think that a lot of traders believe this market is sold-out, but they are **holding off** until we get September and October out of the way. In other words, they do not want to do anything until they are reasonably convinced that this calendar period of great danger (historically) has passed.

Observation: Breadth (advance-decline ratio) has really been the **key to this market** ever since early-April. What we've seen is a **bear market in the great majority of stocks,** a phenomenon illustrated by the steep collapse in the A-D ratio. Nevertheless, the big-cap stocks, at least many of them, have tended to resist the smash. My "Big-Money Breadth Index" never broke down below its June 3 low -- until it does, I am of the opinion that the real back of this market has not been broken. True, the losses have been substantial, but the real losses will appear when the big-caps finally give up the ghost.

Even on the rebound from the August 31 low, the A-D ratio has been a laggard. This shows up dramatically on the page 2 chart. So up to this point it's been a bear market for about 80% of the stocks with the big-cap stocks ragged, some (Disney, Gillette, Merrill, Citicorp) down 40% or more, but on the whole this has not been a disaster for the big stocks -- not yet.

INVESTMENT POSITION: The bear's in the box. Yeah, the market put in a nice rally after August 31, but don't be too thrilled, we'll see a lot of rallies before this bear market is over. Rallies in a bear market exist for the purpose of keeping your hopes up. You're a lot better off keeping your eye on the big picture -- Ursa the bear is in the box, and he means to be there for a while.

This has been a strange and frustrating bear market so far. It's strange because the statistics so far are not that terrible -- but then you have to remember that the statistics are almost always based on "how far the Dow has declined." Investors who are holding portfolios of assorted stocks or those who hold mutual funds know differently. The sad story is that the majority of stocks are down anywhere from 20% or over 50%. Furthermore, there hasn't been much upside action in the non-blue-chip stocks, even on days when the Dow was up over 200 points. So it's been frustrating for most of those investors who are hanging on, hanging on because the "experts" have told them that "over the long haul stocks go up."

You have to remember that each bear market (and bull market) is different, and each has its way of tricking and confusing investors. After all, if it was obvious and easy, everyone would be fully invested in a bull market's first week, and everyone would be out of a bear market one week off the highs. But it just doesn't work that way.

The most impressive sector of the market, as I see it, has been the **D-J Utility Average,** which as I write is not too far from its bull market high. With deregulation in the utility industry and with many first-class utilities providing better than 5% yields, it's not surprising that the utilities are out-performing. If you have to invest conservative amounts of money, I like the action of Texas Utilities, Southern Company and American Electric Power (I recently bought small amounts of all three for my kids). What, buying common stocks in a bear market? Yeah, but only utilities, only small amounts, and only because I believe in compounding (I'll write more about the magic of compounding in a forthcoming Letter).

But the critical consideration in a primary bear market is to **avoid losses.** Your single best bet at this time is to be in Treasury bills. I'm getting bored with recommending Treasury bonds, which I've been recommending for many months. I'm a little bothered when I hear all the bears talking about 4.0% to 4.5% yields on Treasuries, so at this point for new money I'm saying, buy T-bills. However, the strong currency, the "island of safety money," is the Swiss franc. All hail the Swissie.

A subscriber writes to tell me that by compounding and making smart investments, starting in 1981 with $1,800 he now has close to $1 million. On the bear market signal of August 4 he sold 50% of his stocks and put that money into T-bills. He holds nothing but blue-chip stocks now, and he wants to know whether he should sell ALL his stocks, moving entirely into T-bills.

It's just a matter of how much risk you want to take. If he sits with his 50% in blue-chips and we go through a very rough bear market and his blue-chips drop 50%, well then he takes an overall bath of 25%. Is he willing to take that much of a hit? Yes, well then sit tight. But suppose stocks only drop 30%? Or suppose blue chips drop 70%. So the answer is a matter of personal choice.

Let's be honest, this is a primary bear market. **Nobody has any idea of how bad it's going to get.** Personally, I like to sleep nights, and personally, I haven't got the stomach to see my assets slide into the jaws of the bear. So personally, I'm 100% liquid with **no exposure** to common stocks. None, zero, zip.

Question: "Russell, you sissy, where are your guts?"

Answer: Hey, it's a bear market, forget guts, I prefer brains. I follow correct procedure, and correct procedure means respecting the bear. I give the bear 100% respect.

Question: Should I buy long bonds here at these "high prices?"

Answer: I've been recommending T-bonds for months and months. At this point, the main thing is not whether to buy more bonds -- it's to be out of stocks and into Treasury bills, notes, bonds. First things first -- OUT of stocks. As for buying more bonds, at this point you can't be greedy. Bonds have made a

huge move, and they are probably even in the throes of a short squeeze. So even if you're totally in T-bills you're making money because T-bills (cash) buy more and more in the way of stocks as the bear market progresses. So buy more bonds? I'd take it easy here.

NOTES & QUOTES: The following is from Wall Street's favorite economist, Ed Hyman: "Analysts are slashing estimates faster than we can ever recall. In just four weeks, First Call's bottoms up estimate for 3rd quarter S&P operating earnings has dropped from +6.6% year-to-year is just +1.9% . . . Three of our favorite indicators strongly suggest that the US economy is already in a clear slowdown pattern. Our company surveys have clearly rolled over. Our strength vs. weakness economic diffusions index has clearly rolled over. Household employment, which tends to lead payroll employment, has slowed significantly . . . Looks like Greenspan is right: 'It's just not credible that the US can remain an oasis of prosperity, unaffected by the Asian contagion.'"

* *

I read the whole Starr report carefully. And I've followed Clinton's career for years. Here's the **Russell view**. Bill and Hillary had an understanding. They had affection and respect for each other, but they are totally disinterested in sex with each other. It was and is an open marriage. Bill has been having affairs for years, decades, yet the two stayed together. Bill is extremely bright and equipped with an almost photographic memory. He's also very needy and has an obsessive urge to be loved by everyone. Raised almost entirely by women, Clinton is an emotional baby; his "strong mother" and trusted partner in power has always been Hillary. Hillary's unspoken permission: "Do what you want sexually, but do it **discreetly** and keep your paramours out of my sight. I don't want to see them or know about them." As governor of Arkansas, Clinton enjoyed a sexual picnic. He even had his troopers bring the girls to him. In Arkansas, it was "anything goes" and Bill was the sex-king.

Washington was a different story. Clinton as President made seven horrendous mistakes. (1) He acted as if he could do in Washington what he had done in Arkansas. (2) He had a sexual affair with the wrong person, a 21-year old White House intern. (3) He had sex in the most sacred place in the US, the Oval Office. (4) He denied under oath that he had had sex with Monica (using his own weird definition of sex). (5) He lied to everyone, including friends and staff, about his affair -- this over a seven-month period. (6) In a supposed apology, Clinton delivered an absurd, defensive speech, never admitting that he was sorry -- and he stupidly attacked Starr in the same speech. (7) Clinton believed that what he did sexually, even as President, was private, strictly between him and Hillary -- and was nobody else's business. Not in the Oval Office, not with a 21-year old intern. Wrong!

Clinton felt that with his open marriage "agreement" with Hillary, he was entitled to sex with anyone as long as it was discreet. Hillary knew about all his affairs, so why should Clinton feel guilty? And **he didn't feel guilty** -- all his "apologies" were just acting. Mistakes, mistakes, but the die was cast. And the drama unfolds like some strange, surreal nightmare.

The big problem is that Clinton has now totally lost his moral authority. He's become a laughing stock in the eyes of the world and an embarrassment to the US, this at a time when the world desperately needs powerful leaders, particularly a leader from the world's only super-power. The bitter irony: Americans knew all along what Clinton was. He was a liar, an adulterer, a draft-dodger, and a hypocrite. Yet they twice voted for him. Had Clinton had an affair with a 35-year old woman outside the White House, then admitted it, nothing would have happened -- zip. Clinton's lack of judgment brought on his downfall. Clinton's personal bear market is now underway.

* *

I had a long talk with Marty Zweig over the weekend. Marty extends greetings to all his old subscribers and wishes them the best. As for the market, he didn't seem to have any really strong opinions, but said that it bothered him that the price/earnings ratio on the S&P was around 25, still extremely high. As far as Marty and I know, no major bull market has ever started with that kind of a sky-high P/E ratio. Marty, always an avid collector, told me he bought the "Captain America" motorcycle used in the movie, "Easy Rider." I told him I'd like to ride it, but he said, "Sorry, it's still in the crate."

* *

Observers like your editor are wondering whether we're seeing the death of global capitalism. The theory was that huge multinational corporations would pour technology and capital into the less-developed nations, and that this would spur worldwide prosperity. It was a great concept, and it worked -- for a while. The problem is that these less-developed nations had no experience with capitalism and competitive free markets; they loaded up on foreign capital, and when the competition got rough and when the world faced over-production, these nations devalued their currencies, cut back, laid off workers, then fell apart. The aftermath is the virtual wipeout of the middle class in most of the formerly prosperous nations. Every day businesses close down, people are fired, stores are closed, and currencies are whacked. All in all it's the most serious international situation since the Great Depression of the '30s.

The emerging markets have been receiving the bulk of the bad news so far. The raw figures are depressing. Indonesia's economy is expected to decline by more than 54% this year. Thailand by 7 to 8%, South Korea by 5%, while Hong Kong and Malaysia report sharply contracting growth for the first half of 1998.

But emerging markets are not the only threat. Canada, which absorbs 20% of US exports, has been hit by falling commodity prices. Japan, which is the US' second biggest trading partner, is deep in recession. The big current threat is South America, a region which buys a fat 40% of US exports and also a region which receives a large portion of US lending. Most investors' fears now center on Brazil. Brazil is the reigning giant. Over the last four years Brazil has received a total of $25 billion in US investments. Last year US companies sold $16 billion in goods to Brazil, the 11th biggest US export market. Brazil is the economic keystone of S. America, representing 40% of the region's $1.8 trillion output. If Brazil chooses the path of deep recession, it would drag down most of the region with it, particularly Argentina, whose economy is virtually symbiotic with Brazil. So far Brazil has chosen the path of recession in lieu of devaluation, but observers are not so sure that Brazil is going to hold out. A week ago Brazil pushed up interest rates to 30%, a move that strengthened the real but is bound to hurt business. Finally, we have Mexico, our second largest trading partner behind Canada. If a nation's currency is a barometer of its economic health, Mexico is in trouble. Its peso has sunk to a record low of over 10.5 to the dollar. Ah yes, remember the famous Rubin bailout of Mexico, a bailout that in reality bailed out the big US banks and many brokers and mutual funds?

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Have you noticed that instead of using the word "bearish," many brokerage houses are using the euphemism "volatility"? For instance, in the latest Salomon Smith Barney "Portfolio Strategist" publication, they start with this: "We believe the market is likely to remain volatile, with periodic rises and falls in prices, and that it is not likely to sustain a major rise, as it has in recent years after periodic bouts with volatility." **Russell Translation:** "I guess we could be in a bear market" . . . **New Market Test:** Count the number of tear-out coupons in *Money* magazine. As a bear market progresses, and as people become more disillusioned, the number of coupons for things to try or buy steadily declines.

* *

One of the biggest and costliest casualties of this bear market, so far, has been **Disney.** Disney enjoyed huge participation from the investing public. Of course, a lot of this stemmed from the glamour of the Disney name. From a May 5 high of 43, Disney slumped to a low of 24 ½ on September 14, a loss of roughly 43%. Furthermore, Disney has been reluctant to participate in the

September rally. Problems: Sluggish foreign sales at entertainment parks, parks too expensive, stock has almost no yield, stock was way too expensive at the highs.

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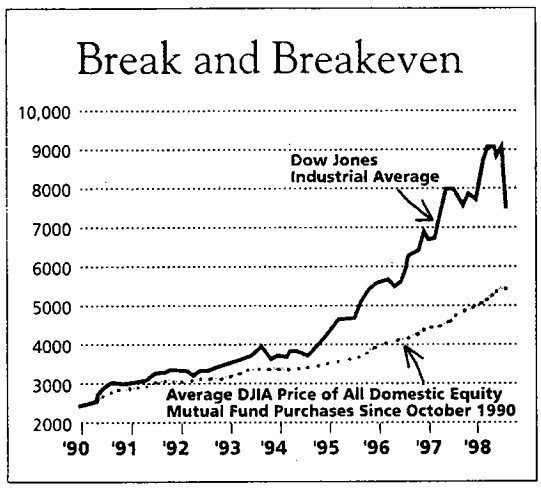
According to Jim Bianco of Bianco Research, 90% of all mutual money came into the funds since October 1990. Bianco figures that the figure at which the average mutual fund (all bought since 1990) would start to go under water is **Dow 5474.** This chart from Alan Abelson's *Barron's* column shows where the Dow would have to fall to send the great majority of funds into the minus column. **Russell Comment:** My guess is that a Dow below 6,000 would set off intense fear on the part of the public and a Dow below 5,000 would trigger panic conditions in the market. Will the Dow get down below 5,000? I set the odds at better than 50/50 that the Dow will drop substantially **below 5,000 before this bear market has ended.**



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Writing about the investing public, the mutual fund investors, the latecomers to the market, Anne Faulk, formerly a Merrill broker and chairman of Faulk & Co., notes, "It's not their fault. They have been led here by wishful scenarios about why this market is exempt from every known law of investing, spun by brokerage-firm analysts who were still sleeping in Brady Bunch pajamas during the last bear market. And if this sell-off lasts, first these investors are going to be angry, then they're going to be terrified. These novice high-rollers are going to receive their first sickening margin calls or they are going to check the mutual fund section of the morning paper to discover their net worth shrinking like an adolescent's self-esteem. It will occur to them that they're playing in a game where they don't belong, by rules they don't understand, with money they can't afford to lose. And they are going to panic, tens of millions of them . . . and that ought to scare anybody."

* *

It is said that conditions and the times produce the man. If so, where are they? In almost every nation the leaders are wobbly and even fighting for their jobs. In the US we have a weakened and embattled President Clinton. In Germany there is Kohl, fighting for his political life. Japan offers Keizo Obuchi, suffering from fierce criticism for his caution in this financial crisis. For Russia there's Boris Yeltsin, fighting off demands for his resignation. Finally, we are offered the IMF's Michel Camdessus, facing fierce criticism for his agency's incompetency. That's the international line-up here in 1998. It could hardly be worse.

* *

For quite a few years the "too big to fail" syndrome ruled (remember the S&Ls and bank bailout?). Now, pertaining to Russia, observers wonder whether the new slogan may be "too dangerous to fail." With its huge nuclear arsenal, Russia presents a problem for the world, but so far it appears that the world is willing to let Russia twist in the wind. After the rescue of US banks and mutual funds in the Mexican peso crisis of 1994-'95, the G-7 announced that "investors must bear the consequences of the decisions they make and should not expect the international community to rescue them when the next sovereign liquidity crisis comes to head." **Russell Comment**: Russia is on its own.

The IMF gave Russia $4.8 billion, and that money promptly disappeared into the foreign bank accounts of assorted corrupt officials. Now it's clear that the Communist party is the only organized political force in the nation. But ironically, the Communists don't have a plan or a program for Russia. They simply want power and all the goodies that go along with that power. So it's Russia, a nation without a currency, without a government and without a clue. It's a nation that has become a loose cannon, and nobody has any idea where the cannon will eventually come to rest. One thing is almost certain -- a Communist dictatorship will not happen again.

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Speaking of the IMF, the agency is now out of money and wants the US to load it up with cash again. Republicans are very reluctant to give the incompetent IMF more dollars, and with good reason. However, there's another possible reason: Many Republicans wouldn't mind if the world were to remain in recession. A world sinking into extended recession would anger Americans and militate towards political CHANGE. The change would, ahem, be a plus for Republicans running for office.

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Big earners often have to learn a bit about frugality. Take Mike Tyson. The man has made over $100 million, but you have to wonder how much is left after all his wild spending. Last week the IRS hit him with the $6.3 million lien. In '97 he was fined $3 million for biting Holyfield's ear. His home is up for sale for $22 million. **Russell Comment:** Big earners should live modestly on the income from their capital. The reason is that most big earners are only big earners for a few years (particularly true in sports).

* *

Speaking of losses, some of the big guys have slimmed just a bit in this bear market. Bill Gates is now down around $5 billion to a net worth of $59 billion. Warren Buffett has lost $7 billion and is now down to a net worth of $34 billion. Coke chairman Douglas Ivester lost $119 million in stock and exercisable options and is down 27% from July 15, when the Coke traded at $88. Bernie Marcus, chairman of Home Depot, saw his net worth drop $470 million from a mid-July high. **Russell Comment**: And the bear market is still young.

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Old war-horses talking: I called my brother-in-law, Lee Bobker, last week and asked he what he thought of the movie, "Saving Private Ryan" (Lee landed at Omaha Beach on D-Day). Lee said it was so close to what it was actually like that it was almost eerie. He said that he had been talking to another buddy of his, a guy who had landed at Omaha with him, and they couldn't get over what a fantastic job Spielberg had done. **Russell Opinion:** An incredible picture of war, a picture that shows you what combat is really like. Which is this: you're fighting to stay alive, fighting to save yourself and your buddies, and anyone who tells you anything different just hasn't been there.

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Once a primary bear market gets going, all the dirty water starts seeping out from under the closet door. With all the incredible emphasis on "beating expectations" on earnings, companies have done all sorts of cutesy things to keep their stocks up and to beat the expectation of earnings. One thesis is that earnings have been heavily overstated in many cases because options have not been factored in to earnings. A London research group believes that the cost of options should be charged against profits and not simply shown as part of employees' remunerations.

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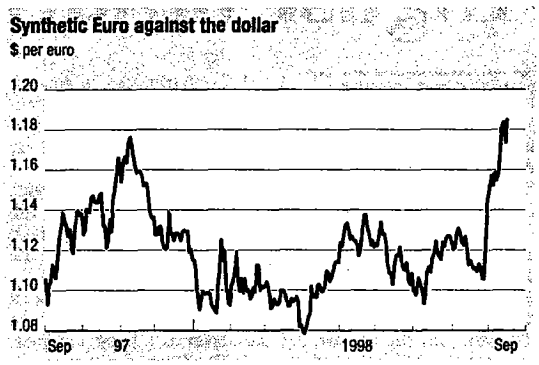
The dollar is losing its status as a "safe haven" for international money. In fact, the strongest currencies around are selected European currencies such as the D-mark and the Swissie; but looming larger and larger is the euro. Although Europe is the world's largest economic and trading power, it has no real voice on the world's stage. But as of January 1, 1999, the 11 members of the euro zone will have a strong voice in the form of the president of the European Central Bank. He'll watch the monetary side of things. Count on it, once the euro becomes official, the euro will offer powerful competition to the dollar. And looking

ahead, that may be the main reason why the dollar has been topping out and why the D-mark is at its highest level in nine months against the dollar.

This is a chart of the synthetic (derivative) euro against the dollar. Note the huge breakout in the euro against the dollar that took place during August-September.



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I told subscribers, I think it was two years ago, that I had given up riding motorcycles, this after riding them for 50 years. I gave 'em up because car drivers have become so aggressive, and because when a guy my age gets banged up, well, you don't recover the way a teenager does. My last bikes were Harley's, but I don't like what Harley has done. Instead of being a cult, Harley is now an "in" thing, and every "bad-boy wannabe" now owns a Harley. Actually, Harley's share of the US big-bike market is now shrinking, and the Japanese are pressing hard. On top of that, two new US big bike companies will be coming out with their own big bikes by the end of this year -- Victory Motorcycles and Excelsior-Henderson. Put it this way -- I'm not sold on Harley as a stock to hold, even in a bull market.

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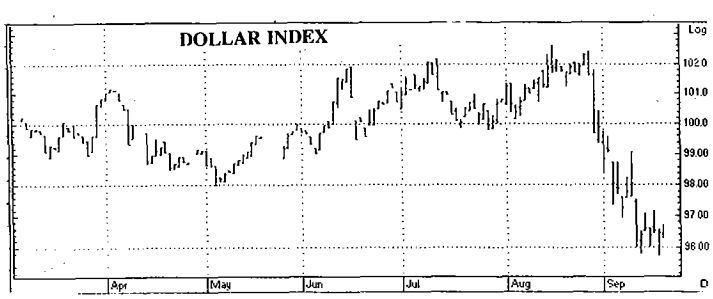
Al Lerner, a Brooklyn-born credit card magnet, just bought the Cleveland Browns NFL franchise for the outrageous price of $530 million, the highest price ever paid for a franchise. What's more, he bought it for cash. You know it has to be an ego trip. If he had put the same $530 million in Treasury paper at say 5.25%, he'd have an income minus worries of $27 million a year and no state taxes on that amount. Can a new Cleveland team generate $27 million in income? I guess Al Lerner will find out.

* *

Master investor Warren Buffett can't be very bullish. He's currently sitting with $9 billion in cash, his largest ever cash position. On top of that he's about to take over General Re along with Re's huge bond position. Asked about what he would do with Re's bonds, Buffett said, "I don't have any desire to convert General Re's to a 100% stock portfolio because I don't see anything to do with it." Interestingly, Buffet is not paying cash (as he often does) for General Re, no, he's buying it with Berkshire paper (stock). Obviously, if Buffett thought Berkshire was a good value he'd keep his stock and use mostly cash.

GOLD, DOLLARS, CURRENCIES: It looks to me as if the Yankee dollar has topped out. How can that be? Well, remember this -- the US is running a trade balance which could be as high as a negative $200 million this year, this while Europe (taken as a unit) runs a positive trade balance. **Note:** Germany just announced that its trade surplus has reached a 10-year high.



In the meantime, in an effort to fight the forces of deflation, almost every nation in the world is inflating its money supply. And the US is no exception. For instance, MZM, money of zero maturity, money that is immediately available and spendable, is rising at a 10% rate.

So we have an ongoing battle. It's a battle between the forces of deflation (global over-production) vs. the forces of inflation (central banks flooding their economies with more paper).

The net result -- gold, the metal, is now off its lows, and has begun to discount the "possibility" of a return to world inflation. And, of course, gold is also responding to the numerous currency devaluations that have occurred around the world. After all, a paper currency can lose 50% of its value overnight; a paper currency can even become worthless overnight. Not so gold. Gold will be around, gold will be money when the dollar and the euro and the yuan and the ringgitt are mere memories.

So that's the picture. Inflation or deflation, both possibilities now exist, and no one knows which will be the winner. Gold doesn't seem to know either. It's off its bottom, but still pushing up rather gingerly.

One interesting possibility: I believe that the brains behind the new European central bank want a strong euro. They want a euro that will compete with the dollar. For that reason, I think there is at least a chance that they will want some percentage of gold-backing behind the euro. If that happens, gold will again come "into the world monetary system." That, I feel strongly, would be a big plus for gold.

Barrick Resources, recommended in the last Letter, recorded a panic bottom at 12 7/8, and has now advanced to around 17-18. If gold is going anywhere, this is a stock to own. I like Newmont Gold, Newmont Mining, and Homestake. Take no big positions in gold now, but this is a good time to start nibbling.

LATE NOTES: The bear raised quite a bit of hell between April and August, and you'd think that by now bruin was entitled to a rest. A rest for the bear would mean an upside correction, or at least a trading range. Following the August 31 low, the market did correct to the upside (see page 2 chart), but the rally fizzled out on September 16, and on September 17 the market headed down again (on Sept. 21 the downside was helped by new 12-year lows in Japan's Nikkei and the release of the Clinton tapes). The big question -- is the market heading for new lows or will the lows hold? The low in the Dow was **7539.07** struck on August 31; the low for Transports was **2616.75** recorded on the same day. For the bear market to continue, **both lows must be broken** . . . Best thing going for the market -- **record yield lows in the long bond and the very superior action of the Utility Average** . . . **Operative thought:** It's a bear market, but remember -- the bear will do anything needed to keep investors optimistic, hoping, and "holding their stocks for the long pull."

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